VZCZCXRO0826
RR RUEHAO RUEHCD RUEHGD RUEHHO RUEHMC RUEHNG RUEHNL RUEHRD RUEHRS
RUEHTM
DE RUEHBU #1291/01 3522121
ZNY CCCCC ZZH
R 182121Z DEC 09
FM AMEMBASSY BUENOS AIRES
TO RUEHC/SECSTATE WASHDC 0222
INFO WESTERN HEMISPHERIC AFFAIRS DIPL POSTS
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHBJ/AMEMBASSY BEIJING 0010
RUEHBS/USEU BRUSSELS 0007
RUEHBY/AMEMBASSY CANBERRA 0007
RUEHEG/AMEMBASSY CAIRO 0007
RUEHFR/AMEMBASSY PARIS 0007
RUEHJA/AMEMBASSY JAKARTA 0007
RUEHKO/AMEMBASSY TOKYO 0007
RUEHLO/AMEMBASSY LONDON 0010
RUEHME/AMEMBASSY MEXICO 0007
RUEHMO/AMEMBASSY MOSCOW 0007
RUEHNE/AMEMBASSY NEW DELHI 0007
RUEHRH/AMEMBASSY RIYADH 0007
RUEHRL/AMEMBASSY BERLIN 0007
RUEHRO/AMEMBASSY ROME 0014
RUEHSA/AMEMBASSY PRETORIA 0009
RUEHUL/AMEMBASSY SEOUL 0007

C O N F I D E N T I A L SECTION 01 OF 04 BUENOS AIRES 001291

SIPDIS
TREASURY FOR WLINDQUIST
SAO PAULO FOR WBLOCK
AMEMBASSY BRIDGETOWN PASS TO AMEMBASSY GRENADA
AMEMBASSY OTTAWA PASS TO AMCONSUL QUEBEC
AMEMBASSY BRASILIA PASS TO AMCONSUL RECIFE

E.O. 12958: DECL: 2019/12/18
TAGS: ECON EFIN EINV ETRD PGOV AR
SUBJECT: Argentina: GOA Creates USD 6.6 Billion Reserves Fund to
Guarantee 2010 Debt Service Obligations

REF: BUENOS AIRES 1279

CLASSIFIED BY: Tom Kelly, DCM; REASON: 1.4(B), (D)

Summary

¶1. (C) The GOA has decided to use Argentina's Central Bank (BCRA) reserves to create a quasi escrow fund to guarantee the payment of its regularly scheduled 2010 debt service obligations. While many analysts think the move will facilitate further government spending and thereby damage Argentina's already deteriorating fiscal situation, they also recognize that it will instill confidence in the short-term regarding the GOA's ability and willingness to pay its external debts coming due in 2010. In fact, the markets responded positively to the plan. Opposition control of the Congress might present an obstacle to its implementation, although it is as yet unclear if the Congress has to authorize the initiative. The BCRA was apparently not informed about the initiative in advance, further compromising its independence, along with its balance sheet. End Summary

-- ---------------------- ------------------

GOA Sets Up Fund to Guarantee Payment of 2010 Debt Servicing

-- ---------------------- ------------------

¶2. (U) On December 14, President Cristina Fernandez de Kirchner, and Economy Minister Amado Boudou announced the creation of a fund using 37 percent of the Central Bank's (BCRA) "excess reserves" - about USD 6.6 billion. Excess reserves are defined as the amount of reserves on hand that exceed the monetary base - cash in circulation plus liquidity requirements. These amount to about USD 18 billion out of total BCRA reserves, which stand now at approximately USD 47.2 billion. The purpose of the fund would be to cover both the interest and principal payments on regularly scheduled GOA debt payments coming due in 2010. This new fund will be named the "Bicentennial Fund for Stability and Reduced Indebtedness" (BF) and will be used to guarantee the availability of sufficient funds to pay Argentina's 2010 debt obligations, thereby, according to the President, clearing away any doubts as to the country's ability and willingness to service its external debt to bondholders and multilateral institutions.

Better Atmosphere for Holdout Deal

BUENOS AIR 00001291 002 OF 004

¶3. (C) Furthermore, with this measure, the GOA seeks to reduce sovereign spreads and create better conditions for an eventual approach to international credit markets. It is likely not a coincidence that this move was made shortly before the scheduled January 12 launching of a new exchange offering for the holdouts from the 2001 debt restructuring deal. During the press conference, Economy Minister Boudou clarified that the reserves the Treasury will receive from the BCRA will not be used to clear the GOA's USD 6.7 billion in payment arrears to the Paris Club, since the GOA prefers restructuring that debt to paying it off all at once. Boudou may have felt the need to add this comment, since the creation of the BF resembles the steps the GOA took in 2005 to pay the full USD 9.5 billion debt to the IMF. At that time, the USD 9.5 billion represented 34 percent of total BCRA reserves, versus the 14 percent that the new fund represents today.

BCRA to Get Below-Market Bond in Exchange

¶4. (U) On December 15, the GOA published the decree establishing the Bicentennial Fund (BF) in the Official Gazette along with some of the details regarding its implementation. In exchange for the USD 6.6 billion in reserves, the GOA will issue a non-tradable 10-year bond to BCRA paying an interest rate similar to the one earned by BCRA reserves with a cap of Libor minus one percent - in other words, at below market rates. While the amount of the funds projected to be involved matches the GOA's 2010 debt payments very closely, including USD 2.2 billion due to international financial institutions and USD 4.4 billion due to private bondholders, it is not yet clear whether the fund will simply guarantee these payments or actually be used to pay them. This is particularly the case since funds to pay these obligations were already set aside in the 2010 budget.

Does Implementing Decree Require Legislative Approval?

-- ----------------------

¶5. (C) Another aspect of the decree which remains unclear is whether or not its implementation requires legislative approval. At present, the law does not allow the use of BCRA reserve funds to pay private creditors. Some observers have noted that a special bicameral commission is needed to approve the changes to the law necessitated by the decree. If so, this could complicate the government's calculations, as the new Congress which was just

seated on December 10 and is now controlled by the opposition may make passage difficult as part of the opposition's general plans to exercise its new power and be more confrontational vis-C -vis the Kirchners.

-- --------------------

Not a Positive Development According to Analysts

-- --------------------

¶6. (C) According to many analysts, the use of BCRA reserves to pay GOA obligations is not a positive development over the long run. Since this move was apparently made without notifying the Central Bank about it in advance, it further damages what was left of BCRA independence. It also weakens the BCRA balance sheet and removes any incentive for the government to control the rapid expansion of expenditures. In fact, it enables a loose fiscal policy, which can be dangerous at a time when GOA fiscal accounts have been deteriorating sharply due to expenditures growing much more quickly than revenues. The primary fiscal surplus is expected to narrow to 0.5 percent of GDP - or lower -- in 2009 versus 3.1 percent in
¶2008. In the long run, investors are likely to be more reassured by solid fiscal management as evidenced by surpluses than by an authorization to use reserves to pay debt obligations.

Markets Reacted Positively

¶7. (C) However, the markets' initial reaction has been positive, leading to some tightening of the Argentina sovereign spread. They appeared to view the GOA initiative as the creation of a sort of "escrow account" which will remove the risk of the GOA being unable to fund its 2010 debt obligations, and the institutionalization of the BCRA's role as the GOA's lender of last resort. (A prominent local banker, Banco Macro president Jorge Brito, also characterized the move as positive in a conversation with the DCM December 16. He said that it reflects recognition by the government that it must avoid a default at all costs.)

-- ----------------------

Money Grab, But Not As Bad As Pension Nationalization

-- ----------------------

¶8. (C) On December 15, Nicholas Duchovny, Chief Economist at Bank Galicia, told Dep EconCouns that the BCRA was purchasing GOA discount bonds in the secondary market. He interpreted this to be a BCRA attempt to tighten spreads and thereby demonstrate that the market viewed the BF announcement positively. Despite characterizing the creation of the fund as a "money grab" by the GOA, Duchovny, in common with some other local analysts, was not overly concerned about the fiscal implications of the measure. Even if it were to be used simply to increase expenditures, he did not think that there was very much money at stake, and therefore, the fiscal impact would be limited. He did agree, however, that no one knows how the new instrument will really be used, and what precedent it will set for the future use of BCRA reserves. While it is clear that the Kirchners are always searching for new financing sources, Duchovny noted that this move was, at least, relatively more benign than last year's pension fund nationalization.
MARTINEZ